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CORPORATE PRO-CHOICE: NEW YORK ASSUMES AN ANTI-TAKEOVER POSITION

Paula Walter*

INTRODUCTION

In the enactment of section 912 to the Business Corporation Law,¹ New York adopted legislation which sharply restricts hostile takeovers. A five year moratorium, mandated by statute, prevents hostile bidders from affecting the second-step in a merger freezeout transaction.² This prohibits an offeror, who acquires at least twenty percent of direct or indirect beneficial ownership of outstanding voting shares of a domestic resident corporation, from voting that block of stock and thereafter from entering into certain business combinations unless the board of the target corporation approves such combination.³ However, provision is made for the board of directors to opt-out of the statute through an amendment of its by-laws.⁴ In the event that such an amend-

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1. Act of Dec. 16, 1985, ch. 915, § 2, 1985 N.Y. Laws 2414, 2414 (McKinney) (codified as amended at N.Y. BUS. CORP. LAW § 912 (McKinney 1986 & Supp. 1992)).

2. N.Y. BUS. CORP. LAW § 912(b) (McKinney 1986).

3. *Id.*

4. *Id.* § 912(d)(3). More specifically, § 912(d)(3) provides, in pertinent part:

(d) The provisions of this section shall not apply:

(3) to any business combination of a resident domestic corporation (i) the original certificate of incorporation of which contains a provision expressly electing not to be governed by this section, or (ii) which adopts an amendment to such resident domestic corporation's by-laws prior to March thirty-first, nineteen hundred eighty-six, expressly electing not to be governed by this section, or (iii) which adopts an amendment to such resident domestic corporation's by-laws, approved by the affirmative vote of the holders, other than interested shareholders and their affiliates and associates

ment is approved by an affirmative vote of the shareholders, other than interested shareholders and their associates, the amendment becomes effective only after an eighteen month period following the shareholders' vote.⁵ The stated purpose of this legislation is "[t]o promote long-term growth of New York resident domestic corporations and to provide New York resident shareholders with full and fair disclosure of the material information required to be filed in a registration statement regarding a takeover bid."⁶ The statute is predicated on the assumption that a hostile takeover compels management to divert its attention from the firm's long term growth and to concentrate instead on short term consequences and on short term stock prices.⁷

The lively debate among economists over whether hostile takeovers are useful and should be encouraged, or dangerous and must be regulated, has been fueled anew with the enactment of section 912.⁸ Despite the negative connotations of the term,

Id.

5. *Id.* § 912(d)(3)(iii).

6. Governor's Memoranda Approval of ch. 915, N.Y. Laws (Dec. 16, 1985), reprinted in 1985 N.Y. LEGIS. ANN. 327.

7. See *id.* Commentators who adopt the thesis that the hostile takeover is a mechanism beneficial to the corporation do so on the belief that inefficient management in a corporation will be reflected in its low stock price which in turn will attract an enterprising bidder, willing to pay premium over the current market price in order to acquire control, who will then turn the fortunes of the company around. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981) (adopting the view that takeovers are beneficial to both shareholders and society).

However, those who dispute the argument that hostile takeovers are beneficial to the corporation articulate instances where the corporation, after acquisition of control by the bidder, lost its inflated stock price either because the raider sold all of the corporation's assets or those assets of the corporation which attributed to its solid status. See, e.g., Martin Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1 (1987) [hereinafter Lipton, *Corporate Governance*] (arguing for takeover reforms and proposing a restriction of abusive takeover tactics).

8. The following are references to literature expressing arguments for and against the regulation of hostile takeovers. The commentators cited below either support the theory that takeovers generate a healthy and productive

many believe that hostile takeovers are good for the national economy because the existence of a market for corporate control ensures long term economic growth by weeding out inefficient and incompetent management.⁹ In opposition are those who

market, or adversely affect long-term planning and are not beneficial for the economy. The themes expressed were adopted prior to the enactment of New York's § 912. See John C. Coffee, *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145, 1221-50 (1984) [hereinafter Coffee, *Corporate Governance*] (discussing that while moderate takeover activity produces a competitive and healthy market, a higher frequency of takeover activity will adversely impact the labor market and employee performance); Easterbrook & Fischel, *supra* note 7, at 1182-88 (advocating "managerial passivity" when a corporation is confronted with a tender offer because society benefits from an active takeover market); William D. Harrington, *If It Ain't Broke, Don't Fix It: The Legal Proprietary of Defenses Against Hostile Takeover Bids*, 34 SYRACUSE L. REV. 977, 1008-14 (1983) (questioning empirical studies that suggest that hostile takeovers are beneficial for the economy and the community at large); Martin Lipton, *Takeover Bids in the Target Boardroom*, 35 BUS. LAW 101, 104-05 (1979) [hereinafter Lipton, *Takeover Bids*] ("Even if there were no empirical evidence that refuted the argument that shareholders almost always benefit from a takeover . . . and even if there were no real evidence, but only suspicion, that proscribing the ability of companies to defend against takeovers would adversely affect long-term planning and thereby jeopardize the economy, the policy considerations in favor of not jeopardizing the economy are so strong that not even a remote risk is acceptable."); Louis Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 COLUM. L. REV. 249, 268 (1983) [hereinafter Lowenstein, *Pruning Deadwood*] ("The efficient market hypothesis has enabled us to avoid the question of whether takeovers are good or bad for the world because the clear answer is that they are good.").

The aforementioned themes continue to apply after the enactment of § 912. See Thomas J. Bamonte, *The Dynamics of State Protectionism: A Short Critique of the CTS Decision*, 8 N. ILL. L. REV. 259, 261 (1988) (stating that economic evidence suggests that tender offers have a positive effect on the economy); Lipton, *Corporate Governance*, *supra* note 7, at 6 (proposing a legislative solution to the grave problems of corporate governance created by the short-term strategy of the institutional investor); William Proxmire, *What's Right and Wrong about Hostile Takeovers*, 1988 WIS. L. REV. 353, 361 (1988) (advocating strong anti-takeover laws because "aside from producing transient profits, takeovers destroy not only companies and jobs, but also shareholder value").

9. Commentators, such as Frank Easterbrook and Daniel Fischel,

support government regulation, claiming that companies do not conform to strict economic models and that takeovers tend to generate paper profits rather than real economic growth.¹⁰

strongly believe that takeovers are useful and should be encouraged because an active takeover market increases social welfare and operates as a mechanism for removing inefficient management. See Easterbrook & Fischel, *supra* note 7, at 1183-84. In response to an article written by Martin Lipton, a celebrated author in the field of corporate governance who advocates regulation of takeovers, Easterbrook and Fischel stated:

The threat of takeovers does not prevent managers from engaging in long-range planning. If the market perceives that management has developed a successful long-term strategy, this will be reflected in higher share prices that discourage takeovers. To be sure, the risk of a tender offer ensures that corporate managers will be unable to assume that they can continue in office indefinitely Some insecurity of tenure is necessary to spur managers to their best performance.

Id.; see also Bamonte, *supra* note 8, at 261 ("The economic evidence shows the positive wealth effects associated with tender offers."); Daniel R. Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1, 45 (1978) (concluding that "[t]he existence of this mechanism gives incumbent management an incentive to perform well and keep stock prices high . . .").

10. Many commentators who believe that takeovers do not generate long-term growth have argued that the problems of corporate governance require a legislative solution. One such commentator, Martin Lipton, has repeatedly argued that the takeover benefits only the corporate raider or troubled management. See Lipton, *Corporate Governance*, *supra* note 7, at 59-60. According to Lipton:

The dominance and short-term investment strategy of the institutional investor have dangerous implications for our economy. Takeovers in the 1980's are driven by speculative, financial considerations rather than by intrinsic business considerations. These takeovers have assumed increasingly abusive forms, endangered a wide variety of constituencies, and generated a host of powerful defensive responses.

Id. at 6-7; see also John C. Coffee, Jr., *The Uncertain Case for Takeover Reform: An Essay on Stockholders, Stakeholders and Bust-ups*, 1988 WIS. L. REV. 435, 438 (1988) (stating that studies have found little evidence of profitability or technical efficiency after the takeover, but rather have determined that there was a loss); Theodore W. Grippio, *In Defense of State Takeover Laws*, 8 N. ILL. U. L. REV. 273, 285 (1988) (proposing reform because "[r]ather than increasing productivity and generating new ideas, corporate resources are being diverted to create elaborate schemes to acquire other companies and to stay one step ahead of the raiders").

Instead of disciplining inefficient management, the opposition claims that bidders, more often called raiders,¹¹ succeed in pillaging the company for the sake of short-term profits and reduce or eliminate entirely the research and development programs of that company.¹² One study concerning the consequences of the New York anti-takeover statute concluded that shareholder wealth decreased in corporations affected by section 912.¹³ The amount of the decrease was estimated at \$1.2 billion, but the rate of such decrease was under one percent.¹⁴ As a corollary of that debate, further policy issues are raised as to which forum, state or federal, is the most appropriate for the regulation of takeovers and tender offers.¹⁵ Should Congress or the individual state

11. The modern corporate "raider" is usually a company or individual seeking to acquire control of another company. According to one author:

A raider can achieve a takeover by a proxy contest or by a tender offer. The tender offer is the more popular takeover method. There are two types of tender offers, a cash tender offer and a public exchange offer. A cash tender offer is an invitation to the shareholders of the target company to tender their shares to the raider in exchange for a premium cash price A public exchange is essentially the same, except that instead of offering cash in exchange for the shares, the raider offers a package compromised of debt and/or equity. .

Grippo, *supra* note 10, at 281 n.26.

12. *See id.* at 281 (stating that corporate raiders seek financial gain for themselves at the expense of economic prosperity of the corporation); Lipton, *Corporate Governance*, *supra* note 7, at 23-24 (arguing that target corporations are forced to focus on short-term profits rather than on economic expansion); Lipton, *Takeover Bids*, *supra* note 8, at 104-05 (overwhelming economic risks of takeovers interfering with long-term planning outweigh any benefit to the shareholder); *but see* Easterbrook & Fischel, *supra* note 7, at 1183 ("Martin Lipton has advanced a related argument But he fails to demonstrate how long-term planning is 'adversely affected.'").

13. Laurence Schumann, *State Regulation of Takeovers and Shareholder Wealth: The Effects of New York's 1985 Takeover Statutes*, BUREAU OF ECON. STAFF REPORT TO THE FED. TRADE COMM'N 1, 45 (March 1987).

14. *Id.* at 45-46.

15. For a discussion supporting the adoption of state anti-takeover legislation see Henry N. Butler, *Corporate Specific Anti-Takeover Statutes and the Market for Corporate Charters*, 1988 WIS. L. REV. 365, 383 (1988) (concluding that state laws provide for diversity in the market place for corporate charters and development of new strategies); Grippo, *supra* note 10, at 278-87 (highlighting the inadequacies of the federal legislation and

legislatures undertake the regulation of the market for corporate control?¹⁶ Which level of government is better equipped to address national policy and to help ensure an efficient and competitive economy? There has been little evidence that Congress is prepared to step into this murky area.¹⁷ Instead, evidence would compel the conclusion that Congress has proceeded with extreme caution, and that the 1968 Williams Act¹⁸ may, in light of recent mergers and acquisitions, be

proposing the enactment of state anti-takeover laws); Proxmire, *supra* note 8, at 363 (arguing that it is the prerogative of the states to enact legislation over matters of corporate governance); *but see* Bamonte, *supra* note 8, at 272 (concluding that state anti-takeover legislation adversely affects the national economy because it restricts the transfer of control over corporate assets and interferes with an open national market); Lowenstein, *Pruning Deadwood*, *supra* note 8, at 321 ("tender offers are federal turf . . . [any] state regulation of tender offers tends to distort and burden what is a quintessentially interstate business").

16. For an interesting discussion of Professor Lowenstein's proposal for an amendment to the Williams Act, see Lowenstein, *Pruning Deadwood*, *supra* note 8, at 317-34.

17. Coffee, *supra* note, 10 at 436 (contrary to the "epidemic-like" character of state anti-takeover legislation, Congress has moved with relative caution with regard to takeover legislation).

Recently, however, numerous bills have been introduced into Congress to amend the Williams Act. For a detailed discussion of proposed federal legislation that would amend the Williams Act, see George C. Hook, *What is Wrong with Takeover Legislation*, 8 N. ILL. U. L. REV. 293, 297-312 (1988).

18. Pub. L. No. 90-439, 82 Stat. 954 (codified as amended at 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1988)). The impact of the federal legislation is neutral. According to Professor Lowenstein:

Though the Williams Act required new disclosures, notably as to the bidder, and provided some substantive protections, such as withdrawal rights and a requirement for proration in the case of partial bids, the statute was not meant to deter tender offers or to alter the "balance" between the two principal protagonists: the bidder and the target company management. The statute was to be "neutral."

Lowenstein, *Pruning Deadwood*, *supra* note 8, at 251.

Some commentators have questioned whether the authors of this legislation could have anticipated, at the time of enactment, the variety and the coercive nature of many bids in which the shareholder feels pressured into tendering even though he may be dissatisfied with the offering price. See Donald C. Langevoort, *The Supreme Court and the Politics of Corporate Takeovers: A Comment on CTS Corp. v. Dynamics Corp. of America*, 101 HARV. L. REV.

somewhat dated.¹⁹ Consequently, political forces at the state level have been successful in enacting protectionist anti-takeover legislation.²⁰

Whereas the judiciary had, in case law prior to *CTS Corporation v. Dynamics Corporation of America*,²¹ succeeded in checking such state anti-takeover legislation, the *CTS* decision marked the death knell of that federal judicial check.²² The *CTS*

96 (1987).

19. See Grippo, *supra* note 10, at 278-79 (stating that there are "several deficiencies in the Williams Act which create loopholes for sophisticated raiders and dilute the protections of federal law"); Langevoort, *supra* note 18, at 113 ("[d]rafters [of the Williams Act] could not have anticipated the variety and occasionally destructive character of the takeover techniques and defensive maneuvers that have become commonplace . . .").

20. For a detailed and critical analysis of the politics underlying state legislation regulating takeovers, see Roberta Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111 (1987).

21. 481 U.S. 69 (1987).

22. In *CTS*, the United States Supreme Court upheld Indiana's statute regulating takeovers against challenges that the statute was preempted by the Williams Act and unconstitutionally interfered with interstate commerce. *Id.* at 78-88. For a discussion of the Indiana statute, see *infra* notes 67-72 and accompanying text. The *CTS* court determined that the statute protects the independent shareholder, and therefore "further[s] a basic purpose of the Williams Act" *CTS*, 481 U.S. at 82. In addition, the Court concluded that the statute did not violate the Commerce Clause because it failed to impose a greater burden on out-of-state offerors than Indiana offerors, and did not "create an impermissible risk of inconsistent regulation by different States." *Id.* at 88-89.

However, five years earlier in *Edgar v. Mite Corp.*, 457 U.S. 624 (1982), the Supreme Court was committed to the tender offer and consequently rejected any infringement to the unfettered use of tender offers/takeovers for the benefit of the national economy through state protectionist anti-takeover legislation. *Id.* at 630-46. In *Mite Corp.*, the Court held that the Illinois statute regulating takeovers frustrated the purposes of the Williams Act and unconstitutionally interfered with interstate commerce. *Id.* at 639, 643-46. Subsequent to the *Mite Corp.* decision, federal circuit courts consistently invalidated state anti-takeover statutes. See *Mesa Petroleum Co. v. Cities Serv. Co.*, 715 F.2d 1425, 1431 (10th Cir. 1983) (holding that Oklahoma's Take-Over Bid Act placed an impermissible burden on interstate commerce); *Telvest Inc. v. Bradshaw*, 697 F.2d 576, 582 (4th Cir. 1983) (concluding that Virginia's Take-Over Bid Disclosure Act, while less burdensome than the Illinois statute at issue in *Mite Corp.*, nevertheless imposed an impermissible

Court does not appear to have considered the issue of open national markets but instead accepted Indiana's stated premise that its legislation was passed with a view to protect shareholders.²³

In the context of this quagmire enters the New York anti-takeover legislation.²⁴ The purpose of this Article is to examine the provisions of section 912 of the Business Corporation Law, analyze its implications, interpret the ramifications of the statute in light of recent case law, and determine whether the states can maintain a meaningful regulatory role within the confines of constitutional parameters.

I. THE LEGISLATION

Section 912 of the New York Business Corporation Law,²⁵ which follows the "business combination model,"²⁶ focuses on

burden on interstate commerce); *Martin-Marietta Corp. v. Bendix Corp.*, 690 F.2d 558, 567-69 (6th Cir. 1982) (enjoining enforcement of the anti-fraud provisions of the Michigan Take-Over Offers Act because they imposed an impermissible burden on interstate commerce); *National City Lines, Inc. v. LLC Corp.*, 687 F.2d 1122, 1133 (8th Cir. 1982) (holding that Missouri's Take-Over Bid Disclosure Act is preempted by the Williams Act and invalid under the interstate Commerce Clause).

23. See *CTS*, 481 U.S. at 82-84. The Court stated that "[a] State has an interest in promoting stable relationships among the parties involved in the corporations it charters, as well as ensuring that investors in such corporations have an effective voice in corporate affairs." *Id.* at 91.

24. N.Y. BUS. CORP. LAW § 912 (McKinney 1986 & Supp. 1992).

25. *Id.*

26. Following *Edgar v. Mite Corp.*, 457 U.S. 624 (1982), academic literature has categorized state anti-takeover statutes by generation. For example, one commentator categorized such statutes into second, third, and fourth generations. See Arthur R. Pinto, *The Constitution and the Market for Corporate Control: State Takeover Statutes After CTS Corp.*, 29 WM. & MARY L. REV. 699 (1988) [hereinafter Pinto, *Corporate Control*].

Second generation statutes include: (i) a shareholder approval model, (ii) a second-tier model, and (iii) a share redemption model. *Id.* at 710. The shareholder approval model requires that the disinterested shareholders, by vote, approve the amassing of shares at specific levels -- the tender offer, in this model, is treated like any other corporate acquisition. *Id.* The second-tier model seeks to protect shareholders of the target corporation at the freezeout

the ability of the tender offeror to use the assets of the target corporation after control of the target has been acquired. The statute does not interfere with the ability of the offeror to acquire these shares or assets. Section 912 requires a shareholder to obtain the approval of the board of directors of the target corporation if he seeks to acquire shares in excess of a specific threshold or for a proposed business combination with the shareholder.²⁷ Inability to obtain such approval will delay this share-

stage or the second stage of the tender offer when the acquirer has achieved control. Such assurance to shareholders may be achieved through a supermajority vote of disinterested shareholders or via a fair price provision. *Id.* at 711. The share redemption model dictates that any shareholder who acquires a given percentage of shares must buy out the outstanding shares at "fair value." *Id.*

Third generation statutes include: (i) voting rights model, and (ii) business combination model. *Id.* at 713. Unlike the statutes representative of the second generation model, the third generation statutes do not restrict the bidder's ability to acquire shares, instead they impose restrictions on the bidder's ability to use these newly acquired shares. *Id.* The voting rights model places restrictions on the acquirer's ability to vote his newly acquired shares. This type of model requires the positive vote of the disinterested shareholders before voting rights in the newly acquired shares are allowed. *Id.* The business combination model requires approval of the target board for either the offeror's acquisition of shares above a given threshold or to effect a proposed business combination with the shareholder. *Id.* at 713-14.

Fourth generation statutes have been referred to as those statutes regulating a foreign corporation within a state where that foreign corporation has a substantial connection with the state either because its principal business is in that state or because a substantial number of assets, shareholders, or employees are in that state. *Id.* at 714-15.

27. N.Y. BUS. CORP. LAW § 912(b) (McKinney 1986). Section 912(b) provides, in pertinent part:

(b) Notwithstanding anything to the contrary contained in this chapter (except the provisions of paragraph (d) of this section), no resident domestic corporation shall engage in any business combination with any interested shareholder of such resident domestic corporation for a period of five years following such interested shareholder's stock acquisition date *unless such business combination or the purchase of stock made by such interested shareholder's stock acquisition date is approved by the*

board of directors of such resident domestic corporation prior to such interested shareholder's stock acquisition date

holder from completing those business combinations for a five year period even after control has been acquired.²⁸ The business combination has been defined to include mergers, consolidations, and sales.²⁹ In short, there is no direct prohibition or deterrence of the tender offer, but instead, the offeror's rights become severely restricted once control of the corporation has been affected.³⁰

The New York State Legislature, simultaneously with the addition of section 912, enacted section 513(e) of the Business Corporation Law,³¹ which prohibits a resident domestic corporation from purchasing more than ten percent of its stock from a shareholder for more than the market value.³² Governor Mario Cuomo's stated purpose for prohibiting such a transaction,

Id. (emphasis added).

28. *Id.*

29. *Id.* § 912(a)(5)(A). This section provides, in pertinent part:

(5) "Business combination," when used in reference to any domestic corporation and any interested shareholder of such resident domestic corporation, means:

(A) any merger or consolidation of such resident domestic corporation with (i) such interested shareholder or (ii) any other corporation (whether or not itself an interested shareholder of such resident domestic corporation) which is, or after such merger or consolidation would be, an affiliate or associate of such interested shareholder

Id.

30. *See id.* § 912(b).

31. Act of Dec. 16, 1985, ch. 915, § 1, 1985 N.Y. Laws 2414, 2414 (McKinney) (codified at N.Y. BUS. CORP. LAW § 513(e) (McKinney 1986)).

32. Section 513(e) provides, in pertinent part:

(e) No resident domestic corporation which is subject to the provisions of section nine hundred twelve of this chapter shall purchase or agree to purchase more than ten percent of the stock of the resident domestic corporation from a shareholder for more than the market value thereof unless such purchase or agreement to purchase is approved by the affirmative vote of the board of directors followed by the affirmative vote of the holders of a majority of all outstanding shares entitled to vote thereon at a meeting of shareholders unless the certificate of incorporation requires a greater percentage of the outstanding shares to approve

N.Y. BUS. CORP. LAW § 513(e) (McKinney 1986).

commonly referred to as "greenmail,"³³ was to discourage "a form of economic coercion that is at the moment legal but has little, if any, redeeming economic or social value to the State or to the nation."³⁴ Article 16 of the Security Takeover Disclosure Act, originally enacted in 1976, was amended³⁵ so as to eliminate the constitutional problems identified by the United States Supreme Court in *Edgar v. Mite Corp.*³⁶ More specifically, section 1612 articulates the requirements of a takeover bid and was drafted to avoid preemption by federal law and, thus, provides that "[i]f the takeover bid is not subject to the requirements of section 14(d) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(d), the following additional requirements shall apply"³⁷ Accordingly, section 1612 was enacted to apply only to takeover bids for shares of any target corporation from New York resident shareholders,³⁸ to provide for additional disclosure of timing requirements³⁹ and to provide for the attorney general to schedule a public hearing or conduct an investigation to determine whether or not the takeover bid is in

33. "Greenmail" refers to that mechanism whereby the target re-acquires its shares from the acquiring bidder at a significant premium above the current price. For a thorough discussion of "greenmail," see Jonathan R. Macey & Fred S. McChesney, *A Theoretical Analysis of Corporate Greenmail*, 95 YALE L. J. 13 (1985).

34. Governor's Memoranda on Bills Vetoed, 1985 N.Y. LEGIS. ANN. 373. Governor Cuomo articulated his opposition to "greenmail" in his memorandum in which he vetoed proposed legislation that would have amended the Business Corporation Law. However, approximately four months after the Governor vetoed the bill, he signed §§ 513(e), 912, and article 16 into law. In his memorandum, the Governor stated that "[t]he objectives of the legislation are identical to the bill that I disapproved last summer for various reasons as set forth in my disapproval message" Governor's Memoranda on Approval of ch. 915, N.Y. Laws (Dec. 16, 1985), *reprinted in* 1985 N.Y. LEGIS. ANN. 331.

35. Act of Dec. 16, 1985, ch. 915, § 4, 1985 N.Y. Laws 2414, 2422 (McKinney) (codified as amended at N.Y. BUS. CORP. LAW §§ 1600-1613 (McKinney 1986)).

36. 457 U.S. 624 (1982).

37. N.Y. BUS. CORP. LAW § 1612 (McKinney 1986).

38. *See* Governor's Program Memoranda on ch. 915, N.Y. Laws (Dec. 16, 1985), *reprinted in* 1985 N.Y. LEGIS. ANN. 330.

39. *See* N.Y. BUS. CORP. LAW § 1612(b), (c) (McKinney 1986).

compliance with article 16.⁴⁰

It is not the objective of this Article to analyze section 513(e),⁴¹ or article 16,⁴² or to determine the constitutional infirmities, if any, of either statutory provision. However, the purpose of this aside is to indicate that the New York State Legislature intended an all-encompassing solution to the perceived difficult issue of hostile takeovers. The legislation was intended to prevent abusive takeover tactics and to provide complete statutory protection to this end.⁴³ An in-depth analysis of section 912 follows.

A. New York Business Corporation Law Section 912

The legislative history of the New York anti-takeover statute is rather revealing of the political process and infrastructure that defines the scope of successfully enacted legislation. The predecessor to the present anti-takeover legislation was a shareholder approval model that had been proposed by the Business Council of New York State.⁴⁴ This bill was vetoed by Governor Mario Cuomo and in his accompanying memorandum,⁴⁵ the Governor cited the Commerce⁴⁶ and Supremacy⁴⁷ Clauses of the United States Constitution. Additionally, the Governor noted the constitutional infirmities of the proposed legislation that would be

40. *Id.* § 1612(f).

41. N.Y. BUS. CORP. LAW § 513(e) (McKinney 1986).

42. N.Y. BUS. CORP. LAW §§ 1600-1613 (McKinney 1986).

43. *See* Governor's Program Memoranda on ch. 915, N.Y. Laws (Dec. 16, 1985), *reprinted in* 1985 N.Y. LEGIS. ANN. 327-30.

44. The proposed legislation was introduced into the senate and assembly. A.6971-A, N.Y. Leg., 1985-86 Reg. Sess. (1985); S. 5846-A, N.Y. Leg., 1985-86 Reg. Sess. (1985).

45. Governor's Memoranda on Bills Vetoed, 1985 N.Y. LEGIS. ANN. 372.

46. U.S. CONST. art. I, § 8, cl. 3 ("The Congress shall have power . . . [t]o regulate Commerce with foreign Nations, and among the several States . . .").

47. U.S. CONST. art. VI, cl. 2 ("This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land . . .").

“inordinately protectionist,” and, “appear[] to go beyond what is allowed us to deal with our clearly manifest local concerns.”⁴⁸ This legislation would have required approval by two-thirds of the shareholders before a party could acquire at least twenty percent of a company’s outstanding stock.⁴⁹ Such requirement would have been waived for an offeror who paid cash to acquire the twenty percent share of a company.⁵⁰ Two-tiered offers would have been prohibited.⁵¹ The vetoed legislation had been proposed prior to the bid by Ted Turner for the Central Broadcast System (CBS).⁵² Because the Governor recognized only constitutional problems and not difficulties with the policy of state regulation of takeovers, the Governor implied that any hostile takeover in New York was a monster to be tamed.⁵³ The Governor further stated that “there is still room in our constitutional design for state law that would provide a more level playing field for the grueling game of corporate takeover.”⁵⁴ With acknowledged justification for state regulation, and with the threatened Turner hostile bid takeover for CBS,⁵⁵ the Governor paved the way for signing into law legislation which would not be voided by the courts on constitutional law grounds. An approximate four month period transpired between the veto date and the date that the new anti-takeover legislation was signed into law.⁵⁶ With a solid basis for the legislation, New York proceeded

48. Governor’s Memoranda on Bills Vetoed, 1985 N.Y. LEGIS. ANN. 374.

49. See A. 6971-A, N.Y. Leg., 1985-86 Reg. Sess. (1985); S. 5846-A, N.Y. Leg., 1985-86 Reg. Sess. (1985).

50. *Id.*

51. *Id.*

52. See Sally B. Smith, *Turner’s CBS Bid Expected Today*, N.Y. TIMES, April 18, 1985, at D6.

53. See Governor’s Memoranda on Bills Vetoed, 1985 N.Y. LEGIS. ANN. 372-74.

54. *Id.* at 373.

55. See *supra* note 52 and accompanying text.

56. The Governor vetoed the initial proposal on August 13, 1985, and approved New York’s Business Corporation Law §§ 912, 513(e), and article 16 on December 16, 1985. See Governor’s Memoranda Approval of ch. 915, N.Y. Laws (Dec. 16, 1985), *reprinted in* 1985 N.Y. LEGIS. ANN. 331.

with the statute as we know it. The New York statute declares that:

(b) Notwithstanding anything to the contrary contained in this chapter (except the provisions of paragraph (d) of this section), no resident domestic corporation shall engage in any business combination with any interested shareholder of such resident domestic corporation for a period of five years following such interested shareholder's stock acquisition date unless such business combination or the purchase of stock made by such interested shareholder on such interested shareholder's stock acquisition date is approved by the board of directors of such resident domestic corporation prior to such interested shareholder's stock acquisition date⁵⁷

To avoid any constitutional questions, a resident domestic corporation is statutorily defined as an insurer of voting stock which:

(13)(A) is organized under the laws of this state; and

(B) either (i) has its principal executive offices and significant business operations located in this state; or (ii) has, alone or in combination with one or more of its subsidiaries of which it owns at least eighty percent of the voting stock, at least two hundred fifty employees or twenty-five percent of the total number of itself and such subsidiaries employed primarily within the state;

(C) has at least ten percent of its voting stock owned beneficially by residents of this state⁵⁸

Thereby, any question of extraterritoriality has been avoided. Section 912 defines an "Interested Shareholder" as:

(10) any person (other than such resident domestic corporation or any subsidiary of such resident domestic corporation) that

(A) (i) is the beneficial owner, directly or indirectly, of twenty percent or more of the outstanding voting stock of such resident domestic corporation; or (ii) is an affiliate or associate of such resident domestic corporation and at any time within the five

57. N.Y. BUS. CORP. LAW § 912(b) (McKinney 1986).

58. *Id.* § 912(a)(13)(A), (B) (McKinney Supp. 1992).

year period immediately prior to the date in question was the beneficial owner, directly or indirectly, of twenty percent or more of the then outstanding voting stock of such resident domestic corporation⁵⁹

The New York approach focuses on the second step transaction of the two-tier takeover. Generally, as a first step, the offeror announces a tender offer for a sufficient number of shares to gain control of the corporation.⁶⁰ The bid, at this stage, is generally made at a price which is higher than the price the offeror has announced he would pay to the remaining shareholders in the second step of the transaction. With the necessary votes for control in order to effectuate what has become known as the freezeout transaction,⁶¹ the shareholder, in the second step of the merger, will be forced to accept the lower price in the freezeout.⁶² Such tactics have been called coercive because shareholders feel compelled to tender early so as to obtain the higher price.⁶³ The less sophisticated shareholder may be hurt because he will fail to tender his stock in a timely fashion and will ultimately lose the higher price. One should be mindful that, often, even at the freezeout price, this shareholder will be receiving a premium over the market price of the shares just prior to the tender offer. To assure a fair price to the non-tendering shareholders, section 912 requires that the price paid to this second group of shareholders be as much as the price offered in the first tier tender of-

59. *Id.* § 912(a)(10)(A) (McKinney 1986).

60. The first step of a two-tiered tender offer occurs when there has been "a cash offer for a controlling interest in the target" Lipton, *Corporate Governance*, *supra* note 7, at 18.

61. In essence, a freezeout transaction is one in which the minority shareholders are forced by the majority shareholders to accept cash or debt in exchange for their shares even though the value they receive may be lower than the actual value of those shares. For a thorough explanation of corporate freezeouts, see Victor Brudney & Marvin A. Chirelstein, *A Restatement of Corporate Freezeouts*, 87 YALE L. J. 1354 (1987).

62. The second step of a two-tiered tender offer occurs when the raider, upon obtaining a controlling interest in the target, "merges the target into itself at a lower second tier price and usually in exchange for securities." Lipton, *Corporate Governance*, *supra* note 7, at 18.

63. See Brudney & Chirelstein, *supra* note 61, at 1367-69.

fer.⁶⁴ The New York legislation has a built-in provision for an opt-out mode from the application of section 912 through the mechanism of an amendment to the corporate by-laws.⁶⁵ The opt-out decision becomes effective only after eighteen months from the date of amendment.⁶⁶

B. Hostile Takeover Statutes in Other Jurisdictions

In order to understand the significance of New York's hostile takeover statute it is necessary to examine legislative approaches of other jurisdictions.

The response of the Indiana statute,⁶⁷ known as the "voting rights model,"⁶⁸ was upheld in *CTS Corporation v. Dynamics Corporation of America*.⁶⁹ This statute mandates that an offeror who acquires a certain percentage of shares must obtain the affirmative vote of the disinterested shareholders in order to have voting rights in those additional shares.⁷⁰ In addition, Indiana's statute has a ten percent interested shareholder requirement,⁷¹ whereas New York's section 912 requires at least twenty percent.⁷²

Wisconsin has also fashioned an anti-takeover statute along the voting rights model.⁷³ Unlike New York, where the offeror may

64. N.Y. BUS. CORP. LAW § 912(c)(3)(A)(i) (McKinney 1986).

65. *Id.* § 912(d)(3)(ii), (iii).

66. *Id.* § 912(d)(3)(iii).

67. IND. CODE ANN. §§ 23-1-42-1 to -11 (Burns 1989).

68. The Indiana statute is a classic example of the voting rights model. *See supra* note 26; *see also* Robert A. Prentice, *The Role of States in Tender Offers: An Analysis of CTS*, 1988 COLUM. BUS. L. REV. 1, 29 (1988).

69. 481 U.S. 69 (1987).

70. IND. CODE ANN. § 23-4-42-5, -9 (Burns 1989).

71. *Id.* § 23-1-42-4(3)(A)-(C). This section defines an "Issuing Public Corporation" as a corporation that has

"(3) Either:

(A) More than ten percent (10%) of its shareholders resident in Indiana;

(B) More than ten percent (10%) of its shares owned by Indiana residents; or

(C) Ten thousand (10,000) shareholders resident in Indiana."

Id.

72. N.Y. BUS. CORP. LAW § 912(a)(10)(A)(i) (McKinney 1986).

73. *See* WIS. STAT. ANN. §§ 180.1101-.1150 (West 1991).

obtain voting power for the newly acquired shares which exceed the statutory threshold,⁷⁴ Wisconsin mandates a restriction limiting such voting power to ten percent for any offeror who acquires more than twenty percent ownership of shares.⁷⁵

Some commentators argue that the voting rights model and the business combination model represent the third generation of state statutes in view of the fact that any restrictions imposed on the offeror's rights occur only subsequent to the offer itself, but the tender process is not interrupted in any way.⁷⁶ That designation is somewhat unrealistic to apply in practice and it becomes especially difficult to separate out the takeover process from its consequence. Therefore, the process will be structured so that the offeror can live with those consequences. The process will be fashioned by its author so that the offeror will find the consequences acceptable, and a suitable mode to work with or around the statutory provisions will be determined.

Maryland has adopted legislation which is designed to prevent the use of coercive tactics on shareholders.⁷⁷ Abuse of shareholders is prevented through legislative enactment that assures the shareholder of a Maryland corporation of either a supermajority vote on the second stage of the transaction, or a fair price to the non-tendering shareholder that would minimally equal the price offered in the first stage of the tender.⁷⁸

74. See N.Y. BUS. CORP. LAW § 912(c) (McKinney 1986).

75. WIS. STAT. ANN. § 180.1150 (West 1991). Section 180.1150 provides, in pertinent part:

(2) Unless otherwise provided in the articles of incorporation of an issuing public corporation and except as provided in sub.(3) or as restored under sub.(5), the voting power of shares of an issuing public corporation held by any person, including shares issueable upon conversion of convertible securities or upon exercise of options or warrants, in excess of 20% of the voting power in the election of directors shall be limited to 10% of the full voting power of those shares.

Id.

76. See, e.g., Pinto, *Corporate Control*, *supra* note 26, at 710-15 (categorizing state anti-takeover statutes by generation).

77. See MD. CODE ANN., CORPS. & ASS'NS §§ 3-602 to 3-709 (1985 & Supp. 1991).

78. *Id.* § 3-602.

Pennsylvania, like her sister state Maryland, avoids the thorny issues created by the two stage tender offer by requiring any shareholder who acquires a certain percentage of stock to buy out the remaining shareholders at "fair value" on their making such demand.⁷⁹ Provisions are made for the determination of "fair value" through appraisal proceedings.⁸⁰ Pennsylvania has also statutorily expanded the judicially derived definition of a corporate director's fiduciary duties.⁸¹ Pennsylvania's legislation now authorizes the board of directors to consider the effects of a takeover on constituencies other than the corporate shareholder and includes employees, suppliers, and the communities within which the corporation is situated.⁸² This expanded definition of a corporate director's fiduciary duties would suggest that defensive tactics should be employed by the board of directors to resist and ultimately defeat hostile tender offers.

II. CONSTITUTIONAL RAMIFICATIONS OF SECTION 912

New York's Business Corporation Law section 912 was enacted into law during the interregnum between the two landmark United States Supreme Court decisions on state anti-takeover

79. See 15 PA. CONS. STAT. ANN. § 2546(a), (c) (1991).

80. *Id.* § 2546(a)(3), (c).

81. *Id.* § 1712(a). Section 1712(a) provides, in pertinent part:

(a) **Directors.**- A director of a business corporation shall stand in a fiduciary relation to the corporation and shall perform his duties as a director, including his duties as a member of any committee of the board upon which he may serve, in good faith, in a manner he reasonably believes to be in the best interests of the corporation and with such care, including reasonable inquiry, skill and diligence, as a person of ordinary prudence would use under similar circumstances. In performing his duties, a director shall be entitled to rely in good faith on information, opinions, reports or statements, including financial statements and other financial data

Id. Additionally, § 1712(b) provides that "[a] director shall not be considered to be acting in good faith if he has knowledge concerning the matter in question that would otherwise cause his reliance to be unwarranted." *Id.* § 1712(b).

82. *Id.* § 1716(a).

legislation.⁸³ In *CTS Corporation v. Dynamics Corporation of America*,⁸⁴ the Supreme Court appeared to contradict its earlier decision in *Edgar v. Mite Corp.*⁸⁵ In fact, Justice White, the author of the plurality opinion in *Mite Corp.*⁸⁶ dissented in the *CTS* decision.⁸⁷ The *CTS* court took a less sanguine view of the virtues of a hostile takeover as the ideal method for re-allocating economic resources and disciplining incompetent management so as to create the ideal market for corporate shares.⁸⁸ Perhaps the

83. New York's Business Corporation Law § 912 was enacted into law on December 16, 1985. See Act of Dec. 16, 1985, ch. 915, § 2, 1985 N.Y. Laws 2414, 2414 (McKinney) (codified as amended at N.Y. BUS. CORP. LAW § 912 (McKinney 1986 & Supp. 1992)). This legislation was approved after the Supreme Court's decision in *Edgar v. Mite Corp.*, 457 U.S. 624 (1982), and before the Court's decision in *CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69 (1987).

For a thorough discussion of the constitutional ramifications of each decision, see Arthur R. Pinto, *Takeover Statutes: The Dormant Commerce Clause and State Corporate Law*, 41 U. MIAMI L. REV. 473 (1987). See also Langevoort, *supra* note 18; Robert A. Profusek & Henry L. Gompf, *State Takeover Legislation After Mite: Standing Pat, Blue Sky, or Corporation Law Concepts?*, 7 CORP. L. REV. 3 (1984); Pinto, *Corporate Control*, *supra* note 26.

84. 481 U.S. 69 (1987).

85. 457 U.S. 624 (1982).

86. A plurality of four Justices, which included Chief Justice Burger, and Justices White, Stevens, and O'Connor, found the Illinois statute to be a direct burden on interstate commerce and therefore invalid. *Mite Corp.*, 457 U.S. at 643.

87. Justice White filed a dissenting opinion in which Justices Blackmun and Stevens joined. *CTS*, 481 U.S. at 97 (White, J., dissenting).

88. See *id.* at 92 n.13. The Court stated:

No one doubts that some unsuccessful tender offers will provide more effective management or other benefits such as needed diversification. But there is no reason to assume that the type of conglomerate that may result from repetitive takeovers necessarily will result in more effective management or otherwise be beneficial to shareholders.

Id.

However, in *Mite corp.*, the Court examined the Illinois statute under the dormant Commerce Clause and stated:

The effects of allowing the Illinois Secretary of State to block a nationwide tender offer are substantial. Shareholders are deprived of the opportunity to sell their shares at a premium. The reallocation of economic resources to their highest value use, a process which can

CTS Court's disenchantment with this mechanism was influenced by the academic literature of the prior five years which seriously questions the assumption upon which the model of the market for corporate control was predicted.⁸⁹ This literature criticized the abusive tactics and the coercion which characterized many tender offers.⁹⁰ Similarly, recurring themes at public hearings indicated ambivalence at the wisdom of sanctioning a vehicle of corporate takeovers, the accompanying attributes of which were often serious economic and social dislocation to the local community.⁹¹ Certainly the spate of recent insider trading scandals, as well as the breakdown of the junk bonds market, the vehicle for financing these takeovers, and the collapse or near collapse of large name brokerage houses would appear to justify the conclusion that state anti-takeover statutes should not be questioned.

In 1968, in response to the increased use of tender offers as the mechanism for gaining control of corporations, Congress adopted the Williams Act.⁹² This Act, which seeks to promote a policy of neutrality between the offeror and incumbent management, favors neither.⁹³ The legislation states its policy not as one of discouragement of tender offers, but instead of their encouragement by compelling easy access to information for investors and by allowing both management and bidder to present their respective cases.⁹⁴ The legislature's objective was to give investors

improve efficiency and competition, is hindered. The incentive the tender offer mechanism provides incumbent management to perform well so that stock prices remain high is reduced.

Mite Corp., 457 U.S. 643 (citing, *inter alia*, Easterbrook & Fischel, *supra* note 7, at 1173-74).

89. See *supra* notes 7-12 and accompanying text.

90. See *supra* notes 10-12 and accompanying text.

91. See *Hostile Takeovers: Hearing Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 100th Cong., 1st Sess. 255 (April 8, 1987) (opening statement of Senator William Proxmire, Chairman of the Committee).

92. Pub. L. No. 90-439, 82 Stat. 954 (codified as amended at 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1988)).

93. See Lowenstein, *Pruning Deadwood*, *supra* note 8, at 251.

94. See *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 56-57 n.5 (1977)

access to relevant information and to eliminate secrecy.⁹⁵ This aim was accomplished by requiring that information be disclosed to investors.⁹⁶ Such disclosure includes revealing information as to the source of funds the offeror is using for the purchase, the purposes of the purchase, and the background, identity, residence, and citizenship of any person on whose behalf the offeror makes the purchases.⁹⁷

The Williams Act preempts any state statute which frustrates the accomplishment of its policy.⁹⁸ State anti-takeover statutes have been held violative of the Commerce⁹⁹ or Supremacy¹⁰⁰ Clauses of the United States Constitution.¹⁰¹ Because the Supremacy Clause makes federal law paramount,¹⁰² a court will invalidate a state law if it conflicts with a federal mandate, if that state legislation frustrates the objectives set by Congress, or where compliance with both state and federal legislation cannot be accomplished.¹⁰³ In a portion of the plurality opinion in *Mite*

(Stevens, J., dissenting) (stating that the legislative intent of the Williams Act was to encourage takeover bids); *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 58-59 (1975) (explaining that the drafters of the Williams Act took "extreme care" in order to prevent tipping the balance of regulation either in favor of management or in favor of the offeror).

95. See *Chris-Craft*, 430 U.S. at 29 ("Neutrality is, rather, but one characteristic of legislation directed toward a different purpose — the protection of investors.").

96. See 15 U.S.C. § 78m(d) (1988).

97. *Id.* § 78m(d)(A)-(E).

98. See, e.g., *Edgar v. Mite Corp.*, 457 U.S. 624, 631 (1982) (discussing that the Williams Act preempts state anti-takeover statutes which conflict with its purpose).

99. U.S. CONST. art. I, § 8, cl. 3.

100. U.S. CONST. art. VI, cl. 2.

101. See, e.g., *Mite Corp.*, 457 U.S. at 639, 643.

102. See U.S. CONST. art. VI, cl. 2 ("This Constitution and the Laws of the United States which shall be made in Pursuance thereof; and all treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land . . ."); *Mite Corp.*, 457 U.S. at 631 ("[o]f course, a state statute is void to the extent that it actually conflicts with a valid federal statute . . .").

103. See, e.g., *Jones v. Rath Packing Co.*, 430 U.S. 519, 526 (1977) ("Our task is 'to determine whether, under the circumstances of this particular case, [the State's] law stands as an obstacle to the accomplishment and

Corp., which only two other Justices joined,¹⁰⁴ Justice White found the Illinois Business Takeover Act¹⁰⁵ to be an obstacle to the accomplishment of Congress' objectives in the Williams Act.¹⁰⁶ Five years later the Supreme Court, in *CTS Corporation v. Dynamics Corporation of America*,¹⁰⁷ found that compliance with both the Williams Act and Indiana's anti-takeover statute¹⁰⁸ was "entirely possible."¹⁰⁹ One should be mindful that even where local state legislation may comply with the Supremacy Clause, any violation of the Commerce Clause will render that statute defective and invalid.¹¹⁰ Justice White, writing for the plurality in *Mite Corp.*, used the balancing test of *Pike v. Bruce Church, Inc.*¹¹¹ to conclude that the burdens placed on interstate

execution of the full purposes and objectives of Congress.'") (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)).

104. Justice White's opinion in which he concluded that the Illinois statute was preempted by the Williams Act was joined only by Chief Justice Burger and Justice Blackmun. *Mite Corp.*, 457 U.S. at 630-40.

105. ILL. ANN. STAT. ch. 121 1/2 para. 137.51-.70 (repealed 1983).

106. *Mite Corp.*, 457 U.S. at 632-40. Justice White reasoned that certain provisions of the Illinois statute conflicted with the purposes of the Williams Act "by providing the target company with additional time within which to take steps to combat the offer These consequences are precisely what Congress determined should be avoided, and for this reason, the notification provision frustrates the objectives of the Williams Act." *Id.* at 635.

107. 481 U.S. 69 (1987).

108. IND. CODE ANN. §§ 23-1-42 -1 to -11 (Burns 1989).

109. *CTS*, 481 U.S. at 79. The Court stated that "[b]ecause it is entirely possible for entities to comply with both the Williams Act and the Indiana Act, the state statute can be preempted only if it frustrates the purposes of the federal law." *Id.*

110. *See id.* at 87-89.

111. 397 U.S. 137 (1970). In order to determine whether state statutes affecting interstate commerce are constitutional, the *Pike* Court stated:

Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

Id. at 142 (citing *Huron Portland Cement Co. v. Detroit*, 362 U.S. 440, 443 (1960)).

commerce by the Illinois Business Takeover Act exceeded the benefits to the regulating state and was therefore invalid.¹¹² Justice White could uphold only those statutes that “regulate[] evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental . . . unless the burden imposed on such commerce is clearly excessive in relation to the putative local effects.”¹¹³

Judge Posner, in his opinion for the United States Circuit Court of Appeals for the Seventh Circuit in *CTS*¹¹⁴ wrote that the Commerce Clause “is all a matter of balancing the benefit to the state’s residents against the burden to out-of-staters.”¹¹⁵ Citing *Pike v. Bruce Church, Inc.*,¹¹⁶ the Seventh Circuit found that the burden imposed on interstate commerce was excessive in relation to the putative local effects.¹¹⁷

The Supreme Court in *CTS* did not scrutinize the Indiana statute carefully nor did it apply the *Pike* test which was to balance the correlative benefits and burdens of the statute.¹¹⁸ The Court merely concluded that the benefits and burdens of the statute correctly belonged within the category of “corporate law,” and as such, was well within the legitimate province of the state to regulate.¹¹⁹ It is possible that the Court avoided a balancing approach because of a perceived concern that the extra-territorial effects of other corporate law statutes would be chal-

112. *Mite Corp.*, 457 U.S. at 640-43.

113. *Id.* at 640 (quoting *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970)); see also *Huron Portland Cement Co. v. Detroit*, 362 U.S. 440, 448 (1960).

114. *Dynamics Corp. of America v. CTS Corp.*, 794 F.2d 250 (7th Cir. 1986), *rev’d*, 481 U.S. 69 (1987).

115. *Id.* at 263.

116. 397 U.S. 137 (1970).

117. *CTS*, 794 F.2d at 263-64.

118. See *CTS*, 481 U.S. at 87-93.

119. *Id.* at 90-94. Addressing the relationship between a state and a corporation that it charters, Justice Powell stated that “[i]t thus is an accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares.” *Id.* at 91.

lenged.¹²⁰ If a state, *a priori*, has the legislative authority to regulate the area of corporations, then all ancillary aspects of corporation law, such as mergers and takeovers, are similarly areas subsumed within the competence of the state to regulate. The *CTS* Court stated that “[n]o principle of corporation law and practice is more firmly established than a State’s authority to regulate domestic corporations”¹²¹

To further emphasize the strong support given to the state regulation of its chartered corporations, the *CTS* Court found that the state has “an interest in promoting stable relationships among parties involved in the corporations it charters, as well as in ensuring that investors in such corporations have an effective voice in corporate affairs.”¹²² The Court stated that it declined to “second-guess the empirical judgments of lawmakers concerning the utility of legislation”¹²³ and found that the statute’s articulation preserves for the shareholders “an effective voice in corporate affairs.”¹²⁴

120. See Langevoort, *supra* note 18, at 106. Langevoort charges that in avoiding the *Pike* test and in adopting the rationale in *CTS*, the Supreme Court was actually proceeding on “artificial” grounds and abetting the perpetuation of the charade staged by the State of Indiana in its assertion that the concern of the state, as reflected in its legislation, was directed toward shareholders’ protection. *Id.* at 116-17. Langevoort faults the Court for not being candid and not conceding that the state was motivated by the protectionist desire to retain local employers, prevent plant closedowns, layoffs, and movement of jobs to other states. *Id.* at 116-18.

121. *CTS*, 481 U.S. at 89. The Court stated that “[s]o long as each State regulates voting rights only in the corporations it has created, each corporation will be subjected to the law of only one State.” *Id.*

122. *Id.* at 91.

123. *Id.* at 92 (quoting *Kassel v. Consolidated Freightways Corp.*, 450 U.S. 662, 679 (1981) (Brennan, J., concurring)). Further, the Court noted that the Constitution does not mandate that each state adhere to a specific economic theory. *Id.*

124. *Id.* at 91. The Court reasoned that the primary objective of the statute is to protect the shareholders of Indiana corporations. *Id.* Specifically, when a takeover is made, the statute provides that shareholders be given an opportunity to decide whether a change in voting control would be beneficial. *Id.* Since a change in management may significantly affect a shareholder’s interest, the Court stated that it is “the State’s role as overseer of corporate governance to offer this opportunity.” *Id.*

In Justice Scalia's concurring opinion, he stated that the Court was not an institution best suited to balance the benefits and burdens of state regulation.¹²⁵ Under this kind of analysis most state anti-takeover legislation should pass muster as the pivotal synapse is state incorporation.¹²⁶

The question which remains unresolved, after the *CTS* analysis of the Commerce Clause, is to what extent this "corporation law" category will permit the state to enact legislation governing corporations without offending interstate commerce? How far can a state protect corporate interests without overstepping its constitutional parameters and burdening interstate commerce? Only Justice White, author of the plurality opinion in *Mite Corp.*, wrote a dissenting opinion in *CTS* and concluded that the Indiana statute imposed a direct restraint on interstate commerce.¹²⁷ The *CTS* Court ratified the perspective that the state's role and competence to regulate takeovers will not easily be challenged by the courts.

New York's Business Corporation Law section 912¹²⁸ was

125. *Id.* at 95 (Scalia, J., concurring). According to Justice Scalia: Nothing in the Constitution says that the protection of entrenched management is any less important a "putative local benefit" than the protection of entrenched shareholders, and I do not know what qualifies us to make that judgment — or the related judgment as to how effective the present statute is in achieving one or the other objective — or the ultimate (and most ineffable) judgment as to whether, given importance-level x, and effectiveness-level y, the worth of the statute is "outweighed" by impact-on-commerce z.

Id.

126. *See id.* at 95-96 (Scalia, J., concurring). Justice Scalia asserted that "[a]s long as a State's corporation law governs only its own corporations and does not discriminate against out-of-state interests, it should survive this Court's scrutiny under the Commerce Clause" *Id.*

127. *Id.* at 99-101 (White, J., dissenting). Justice White, along with Justices Blackmun and Stevens, found that the effect of the Indiana Act was to restrict the transfer of shares in an interstate market. *Id.* at 100. Justice White stated that "[t]he Commerce Clause was included in our Constitution by the Framers to prevent the very type of economic protectionism Indiana's Control Share Acquisitions Chapter represents" *Id.* Accordingly, Justice White concluded that the statute unconstitutionally conflicted with the Commerce Clause. *Id.* at 101.

128. N.Y. BUS. CORP. LAW § 912 (McKinney 1986 & Supp. 1992).

drafted to avoid the constitutional pitfalls of earlier models held unconstitutional by the courts.¹²⁹ As such, the provisions of the statute apply only to resident shareholders of domestic resident corporations with significant assets within the state.¹³⁰ Thus, the New York statute that was passed into law prior to the *CTS* decision and that may have been constitutional according to earlier case law, would now certainly be sanctioned.

Four cases, since the enactment of section 912, have sought to challenge the anti-takeover legislation.¹³¹ It is this author's contention that none of these cases, in any way, discusses possible constitutional challenges based on the Supremacy or Commerce Clauses of the United States Constitution. Although section 912 of the New York Business Corporation Law has been litigated in the context of an anticipated takeover, the constitutional issues were not central to the legal debate raised. These cases will be discussed in chronological order.

In the first case,¹³² argued before the United States District Court, the Long Island Lighting Company (LILCO), as part of its twin motions for summary judgment and a preliminary injunction, sought to question that provision of the New York Long Island Power Authority Act that exempted the Long Island Power Authority (LIPA) from the terms of section 912.¹³³ To impugn the constitutional foundation of the legislation, an argument was mounted based on the consequences of section 912 which, LILCO asserted, would impact negatively on New York State's economy because of the reduced work force resulting from this

129. See *supra* notes 44-56 and accompanying text.

130. See N.Y. BUS. CORP. LAW § 912(a)(10) (McKinney 1986).

131. See *Avon Products, Inc. v. Chartwell Assocs. L.P.*, 738 F. Supp. 686 (S.D.N.Y.), *aff'd*, 907 F.2d 322 (2d Cir. 1990); *Salant Acquisition Corp. v. Manhattan Indus., Inc.*, 682 F. Supp. 199 (S.D.N.Y. 1988); *Long Island Lighting Co. v. Cuomo*, 666 F. Supp. 370 (N.D.N.Y. 1987), *appeal dismissed*, 888 F.2d 230 (2d Cir. 1989); *Bank of New York Co. v. Irving Bank Corp.*, 142 Misc. 2d 145, 536 N.Y.S.2d 923 (Sup. Ct. New York County 1988).

132. See *Long Island Lighting Co. v. Cuomo*, 666 F. Supp. 370 (N.D.N.Y. 1987), *appeal dismissed*, 888 F.2d 230 (2d Cir. 1989).

133. *Long Island Lighting*, 666 F. Supp. at 408.

legislation.¹³⁴ The court categorically dismissed LILCO's argument.¹³⁵ The reasoning of the decision in support of the waiver was a juridical recognition of New York State's legitimate exercise of its police power prerogative.¹³⁶ Therefore, the LIPA exemption passed constitutional muster insofar as the substantive due process issues raised under the Fourteenth Amendment of the United States Constitution.¹³⁷ The court did not consider any other constitutional law issues, such as preemption or the Commerce Clause, which section 912 may have engendered.

In 1988, with only a few months between the decisions, two distinct courts, one, a United States district court, and the other, a New York State supreme court, separately considered the effect of New York's anti-takeover mandate.¹³⁸ In *Salant Acquisition Corp. v. Manhattan Industries, Inc.*, filed in federal court, the plaintiffs sought to establish that section 912, because of its "chilling effect," could cause shareholders to doubt whether a share tender "would serve any purpose," and consequently, inhibit the tender offer.¹³⁹ The southern district found this reasoning specious, the argument too speculative to necessitate adjudication, and held that many factors other than the legislation could cause the demise of a tender offer.¹⁴⁰

That same year, a New York State supreme court had the occasion to entertain a motion by the Bank of New York, the plaintiff, which sought to enjoin the Irving Bank Corporation (IBC), the defendant, from enforcing a "flip-in" provision adopted by the IBC board as part of its defensive plan to render

134. *Id.*

135. *Id.*

136. *Id.* The court stated that "the legislature's decision to exempt LIPA from the requirements of § 912 was a legitimate exercise of the state's police power." *Id.*

137. U.S. Const. amend. XIV, § 1 (No State shall make any law which shall . . . deprive any person of life, liberty, or property, without due process of law").

138. See *Salant Acquisition Corp. v. Manhattan Indus., Inc.*, 682 F. Supp. 199 (S.D.N.Y. 1988); *Bank of New York Co. v. Irving Bank Corp.*, 142 Misc. 2d 145, 536 N.Y.S.2d 923 (Sup. Ct. New York County 1988).

139. *Salant*, 682 F. Supp. at 204.

140. *Id.*

an acquisition of IBC shares prohibitive and unprofitable.¹⁴¹ In this motion for a preliminary injunction, the plaintiff argued that the IBC board should be directed to approve or waive rights under section 912.¹⁴² No constitutional issues were raised in this motion; instead, the plaintiff sought to compel enforcement of the statutory provisions.¹⁴³ In granting the preliminary injunction, the court chose to defer judgment on a direction pursuant to the section 912 provision, precisely because this was only a preliminary hearing and not a complete factual hearing on the issue of the directors' exercise of their judgment.¹⁴⁴

In the most recent challenge to section 912, the United States District Court, Southern District of New York, was called upon to adjudicate the constitutional validity of a defensive shareholders plan in *Avon Products, Inc. v. Chartwell Associates L.P.*¹⁴⁵ As part of that quest, the shareholders asked for guidance regarding the New York anti-takeover statute and a judicial ruling to determine whether that mandate violated either the Supremacy Clause or the Commerce Clause of the Constitution.¹⁴⁶ The *Avon* case was the first to question section 912 for possible constitutional law violations. However, when the action was moved from the state to the federal court,¹⁴⁷ the constitutional issues were side-stepped, because in the district court the defensive shareholder plan was invalidated on corporate law provisions alone and not on any constitutional law bases.¹⁴⁸

In conclusion, therefore, in each of these cases to which a sec-

141. *Bank of New York*, 142 Misc. 2d at 145-46, 536 N.Y.S.2d at 923.

142. *Id.*

143. *Id.* at 147-48, 536 N.Y.S.2d at 924-25.

144. *Id.* at 150, 536 N.Y.S.2d at 926.

145. *See Avon Products, Inc. v. Chartwell Assocs. L.P.*, 738 F. Supp. 686 (S.D.N.Y.), *aff'd*, 907 F.2d 322 (2d Cir. 1990).

146. *Id.* at 688.

147. Initially, *Avon* commenced a suit in a New York State court seeking a declaratory judgment that its plan was valid and that § 912 was constitutional. *Id.*

148. The court concluded *Avon's* plan violated § 501(c) of the Business corporation Law because *Avon* created a discrimination between shares of stock. *Id.* at 690-91. *See also* N.Y. BUS. CORP. LAW § 501(c) (McKinney 1986 & Supp. 1992).

tion 912 reference is made, a determination of its constitutional law ramifications was not rendered. It should be noted that the legal forum for each case was on the basis of a motion hearing rather than a full hearing on the merits of the case. Could it be that these courts proceeded on the assumption that any discussion predicated on the constitutional question was premature? The verdict on the constitutionality of section 912 has not been rendered. At this juncture, any incipient judicial nibble is simply not dispositive of any constitutional issue.

CONCLUSION

The New York legislation has been adopted and the courts have ruled positively on state takeover legislation.¹⁴⁹ Yet, residual questions linger about the desirability of state regulation of takeover bids. Tensions remain between federal and state legislatures, and the public has not been provided with a satisfactory expression of accommodation of that tension. On the one hand, the theme of the literature on law and economics emphasizes the need for corporate control in national economic life.¹⁵⁰ On the other hand, state corporation law created bequests of a different nature and its beneficiaries have, at times, been constituencies not traditionally benefitted by the corporate law. Local markets and economics have been propped up and socio-economic dislocation spared.

The courts had, in case law prior to *CTS*, found nationwide securities markets beyond the regulatory control of state law.¹⁵¹ The earlier case law discusses the Supremacy and the Commerce Clauses of the Constitution and demonstrates how that document allocates governance of these matters between the federal and state levels respectively and assigns roles to each segment in the national economy.¹⁵² States could not pursue local protectionist policies. Such a parochial economic weltanschauung was to be

149. For a discussion of various state anti-takeover statutes see Bamonte, *supra* note 8; Grippo, *supra* note 10.

150. See *supra* notes 7-12 and accompanying text.

151. See *supra* notes 22-23 and accompanying text.

152. *Id.*

submerged for the benefit of the national whole. The Court, in a change-of-heart position in *CTS*, tipped the scale significantly in favor of states' regulation of the market for corporate control.¹⁵³ The *CTS* Court justified its newer formula by ceding to the states the absolute right to regulate corporations chartered by that state.¹⁵⁴ Through its nexus of incorporation, states acquired the immutable right to regulate the corporation and all aspects of governance for that corporate entity.¹⁵⁵ The *CTS* Court restricted the use of the Constitution as a vehicle for the protection of the market for corporate control. But, that Court chose to overlook the protectionist attributes of the state legislation which contradicts the Constitution's careful division of federal and state balances and chose instead to ratify the state's competence in this sphere. Yet, the controversy remains unsettled as to which role the states should have allocated to it and what the federal government should appropriate to itself in the entire takeover context. As its legacy, *CTS* has left many unanswered and still-to-be debated policy issues which the New York legislation cannot begin to answer.

153. See *CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69, 87-94 (1987).

154. *Id.* at 91-93. The Court stressed that states have an interest in protecting the parties involved in its corporations and in ensuring that investors have an effective voice in corporate affairs. *Id.* at 91.

155. See *id.* at 93-94. In dismissing Dynamics' argument, the Court stated that "[w]e reject the contention that Indiana has no interest in providing for the shareholders of its corporations the voting autonomy granted by this Act." *Id.* at 93 (emphasis added).